No. 16,458

In the United States Court of Appeals for the Ninth Circuit

GEORGE Y. ERLANDSON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decision of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The memorandum findings of fact and opinion below (R. 28-35) were not reported.

JURISDICTION

This petition for review (R. 37-39) involves federal income taxes for the taxable year 1954. On December 14, 1956, the Commissioner of Internal Revenue mailed to the taxpayer notice of deficiency in the total amount of $1,960.38. (R. 5-6.) Within ninety days thereafter and on January 23, 1957, the taxpayer filed a petition with the Tax Court for a

redetermination of that deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954. (R. 3-8.) The decision of the Tax Court was entered on January 15, 1959. (R. 36.) The case is brought to this Court by a petition for review filed March 26, 1959. (R. 37-39.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court correctly held that wages earned by the taxpayer while serving aboard a ship owned by the United States and operated by a private shipping firm under a general agency contract were paid by the United States or an agency thereof, and hence were not tax-exempt under Section 911 (a) (2) of the Internal Revenue Code of 1954.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 911. EARNED INCOME FROM SOURCES WITHOUT THE UNITED STATES.
>
> (a) *General Rule.*—The following items shall not be included in gross income and shall be exempt from taxation under this subtitle:
>
> * * * *
>
> (2) *Presence in foreign country for 17 months.*—In the case of an individual citizen of the United States, who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, amounts received from sources without the United

> States (except amounts paid by the United States or an agency thereof), if such amounts constitute earned income (as defined in subsection (b)) attributable to such period; * * *
>
> * * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 911.)

STATEMENT

Most of the facts bearing upon the question on appeal were stipulated (R. 9-10) and such facts, as recited by the Tax Court (R. 28-34), may be summarized in the following manner:

In January 1952, the taxpayer signed shipping articles at Portland, Oregon, to serve as Second Officer aboard the M/V Jumper Hitch. (R. 29.)

The United States of America owned the Jumper Hitch. Through and by the Director, National Shipping Authority of the Maritime Administration, Department of Commerce, the United States entered into a general agency agreement for the operation of the ship with Pacific Far East Line, Inc. (R. 29.) This Service Agreement, dated April 16, 1951, was contract number MA-82-GAA, and in part provided the following (R. 29-33):

> This Agreement, made as of April 6, 1951, between the United States of America (herein called the "United States") acting by and through the Director, National Shipping Authority of the Maritime Administration, Department of Commerce, and Pacific Far East Line, Inc., a corporation organized and existing under

the laws of Delaware, (herein called the "General Agent"):

* * * *

Article 1. Appointment of General Agent. The United States appoints the General Agent as its agent and not as an independent contractor, to manage and conduct the business of the vessels assigned to it by the United States from time to time and accepted by the General Agent.

Article 2. Acceptance of Appointment. The General Agent accepts the appointment and undertakes and promises so to manage and conduct the business for the United States, in accordance with such directions, orders or regulations not inconsistent with this Agreement as the United States has prescribed, or from time to time may prescribe, and upon the terms and conditions herein provided, of such vessels as have been or may be by the United States assigned to and accepted by the General Agent for that purpose.

Article 3. Duties of the General Agent. For the account of the United States, in accordance with such directions, orders, regulations, forms and methods of supervision and inspection as the United States may from time to time prescribe (or in the absence of such directions, orders, regulations, forms and methods of supervision and inspection, in accordance with reasonable commercial practices and/or the use of customary commercial forms), in an economical and efficient manner, and exercising due diligence to protect and safeguard the interests of the United States in connection with the duties prescribed in this Agreement and without preju-

dice to its rights under Article 6 hereof, the General Agent (solely as agent of the United States and not in any other capacity) shall:

* * * *

(b) Collect, deposit, remit, disburse and account for all monies due the United States arising in connection with activities under or pursuant to this Agreement, and to the extent disbursements made by the General Agent pursuant to this Agreement are recoverable from insurance, the General Agent shall take such steps as may be appropriate to effect such recovery for the account of the United States.

* * * *

(d) Procure the Master of the vessels operated hereunder, subject to the approval of the United States. The Master shall be an agent and employee of the United States, and shall have and exercise full control, responsibility and authority with respect to the manning, navigation and management of the vessel. The General Agent shall procure and make available to the Master for engagement by him the officers and men required by him to fill the complement of the vessel. Such officers and men shall be procured by the General Agent through the usual channels and in accordance with the customary practices of commercial operators and upon the terms and conditions of the General Agent's collective bargaining agreements, if any. The officers and members of the crew shall be subject only to the orders of the Master. All such persons

shall be paid in the customary manner with funds provided by the United States hereunder.

* * * *

(f) Furnish and maintain during the period that any vessel is assigned and accepted by the General Agent under this Agreement, at its own expense, a bond with sufficient surety in such amount as the United States shall determine such bond to be approved by the United States as to both sufficiency of surety or sureties and form, and to be conditioned upon the due and faithful performance of all and singular the covenants and agreements of the General Agent contained in this Agreement, including without limitation of the foregoing the condition faithfully to account to the United States for all funds collected and disbursed and funds and property received by the General Agent or its sub-agent. The General Agent may, in lieu of furnishing such bond, pledge direct or fully guaranteed obligations of the United States of the cash value of the penalty of the bond under an agreement satisfactory in form to the United States.

No monies or slop chest property of the United States shall be advanced or entrusted by the General Agent to a Master, purser or any other member of the ship's personnel unless such person is under a bond indemnifying the United States against loss of such monies or property caused solely or in part by the dishonesty or lack of care of any such person in the performance of

the duties of any position covered by the bond.

(g) (1) Keep books, records and accounts (which shall be the property of the United States) relating to the activities, maintenance and business of the vessels covered by this Agreement in such form and under such regulations as may be prescribed by the United States; * * *

There is an addendum dated October 5, 1951, to the above agreement providing, in part, the following (R. 33-34):

Article 5. Disbursements. * * * The United States shall also advance funds to the General Agent to provide for, and the General Agent shall receive credit for, all crew expenditures accruing during the term hereof in connection with the vessels assigned hereunder, including, without limitation, expenditures on account of wages, extra compensation, overtime, bonuses, penalties, subsistence, repatriation, internment, travel, loss of personal effects, maintenance and cure, vacation allowances, damages or compensation for death or personal injury or illness, insurance premiums, Social Security taxes, state unemployment insurance taxes and contributions made by the General Agent to a pension or welfare fund with respect to the period of this Agreement and in accordance with a pension or welfare plan in effect on the effective date of this Agreement or which, pursuant to collective bargaining agreements, may become effective during the period of this Agreement with respect to officers and members of the crew of said vessels who are or may become entitled

to benefits under such plan, or any other payment required by law.

It has been orally stipulated that the United States provided the general agent with funds for the wage payments due the officers and crew of the Jumper Hitch from the Civil Operations Revolving Fund created by Congress in 1951. Third Supplemental Appropriation Act, 1951, c. 121, 65 Stat. 52, 59. (R. 34.)

In April 1954, the taxpayer was paid $10,299.97 by the United States Government's general agent, Pacific Far East Line, Inc., for his services performed aboard the Jumper Hitch. (R. 34.)

Following its decision in *Teskey* v. *Commissioner*, 30 T. C. 456 (reproduced in the Appendix, *infra*), the Tax Court held that the wages received by the taxpayer were "amounts paid by the United States or any agency thereof", within the meaning of the exception clause of Section 911(a)(2), and that therefore his wages are not exempt from taxation under that section. (R. 34-35.)[1]

SUMMARY OF ARGUMENT

Section 911(a)(2) of the 1954 Code provides that income earned abroad by a United States citizen shall be excluded from his gross income if he has been present in a foreign country for a specified period, but excepts from this exemption "amounts paid by the United States or any agency thereof."

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[1] The Commissioner conceded below that the taxpayer was present in a foreign country, as prescribed by Section 911 (a)(2), Internal Revenue Code of 1954. (R. 29.)

It is clear, as the Tax Court held, that the taxpayer's salary as an officer aboard the ship, Jumper Hitch, was paid by the United States or an agency thereof and, accordingly, that the taxpayer may not avail himself of the benefits of the section.

The record establishes that the vessel was owned by the United States and operated during the year in question, 1954, by Pacific Far East Line, Inc., as a general agent of the United States. As provided in the agency agreement, the taxpayer was paid with United States funds, advanced to Pacific for the specific purpose of meeting vessel operating expenses such as wages. In this respect, Pacific was a mere conduit for the payment of such wages by the United States to the taxpayer. Under the agreement the sums advanced were not held by Pacific under any color of title other than as agent for the United States. Pacific's compensation for the operation of the vessel was not derived from the funds so advanced, but was separately paid on a monthly basis.

The broad language of Section 911(a)(2) does not even require that the taxpayer be an employee of the United States, but merely that he be "paid by the United States." Even assuming otherwise, however, it would appear that he was in fact such an employee. The statutory provisions creating the fund from which the United States drew the sums advanced to Pacific characterizes seamen like the taxpayer as "employees" of the United States; and the Supreme Court has held (*Cosmopolitan Co.* v. *McAllister*, 337 U.S. 783) that a seaman who was hired pursuant to an agreement substantially identical to

the agreement in the present case was an employee of the United States.

The Tax Court's decision is in accord with its own prior decisions in similar cases (see *Teskey* v. *Commissioner*, 30 T.C. 456) and with a revenue ruling on the issue. The taxpayer's argument ignores the plain terms of the agency agreement, which expressly obligated the United States to pay the wages in question and the stipulated fact that the funds out of which they were paid were provided by the United States. The taxpayer does not (and cannot) point to any authority which supports his position.

ARGUMENT

The Taxpayer Was Paid By the United States, Or An Agency Thereof, and, Accordingly, His Income Is Not Exempt From Taxation Under the Provisions of Section 911 of the Internal Revenue Code of 1954

Section 911(a)(2) of the Internal Revenue Code of 1954, *supra*, states that amounts constituting earned income from sources without the United States shall be excluded from the gross income of an individual citizen of the United States who establishes that he has been present in a foreign country for at least seventeen out of eighteen consecutive months, *provided* that such amounts are not paid by the United States or an agency thereof.[2] A brief de-

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[2] The section was first enacted as Section 116(a) of the Revenue Act of 1932, c. 209, 47 Stat. 169, for the purpose of relieving citizens living abroad of the double burden of foreign and domestic tax upon the same income. S. Rep. No. 665, 72d Cong., 1st Sess. (1932) (1939-1 Cum. Bull. (Part 2) 496, 518). While the Senate version of the 1932

scription of the circumstances under which the taxpayer was employed and paid here seems sufficient to establish that he was "paid by the United States or an agency thereof," and, accordingly, is not entitled to the benefits of this section.

The taxpayer was employed on the vessel Jumper Hitch, owned by the United States and operated during the year in question here, 1954, by Pacific Far East Line, Inc., under an agreement entered into in 1951 with the Director, National Shipping Authority of the Maritime Administration, Department of Commerce. (R. 29.) Under the terms of the agreement, Pacific was appointed as an "agent and not an independent contractor, to manage and conduct the business" of the United States. (R. 30.) And the agreement set forth in some detail the operational duties and responsibilities of the agent. (R. 30-33.) One of the requirements was that Pacific procure a master to actually operate the ship (who was to be an agent and employee of the United States) and make available to the master for hire by him officers and men to fill the complement of the ship. (R. 31.)

Revenue Act struck out the section altogether, S. Rep. No. 665, *supra*, the provision was restored at conference with the amendment that the exclusion from income would not apply to amounts paid by the United States. H. Conference Rep. No. 1492, 72d Cong., 1st Sess. (1932) (1939-1 Cum. Bull. (Part 2) 539, 543). Apparently, this amendment, with which we are concerned here, was intended to prevent exemption from United States tax for citizens who also paid no foreign tax. S. Rep. No. 665, *supra*. See *Sverdrup* v. *Commissioner*, 14 T.C. 859. The record does not show, nor does the taxpayer claim, that he paid any foreign tax on the income in question.

The officers and crew were to be hired through usual channels of commercial practice, were to be subject only to the orders of the master, and, most important in terms of the present case, were to be "paid in the customary manner with funds provided by the United States." (R. 31-32.)

The agreement specifically provided that the United States shall "advance funds to the General Agent to provide for * * * expenditures on account of wages." (R. 33.) The parties have orally stipulated (R. 34) that the funds so provided for the wage payments due officers and crew of the Jumper Hitch are from the Civil Operations Revolving Fund created by Congress in 1951 for the express "purpose of carrying out vessel operating functions of the Secretary of Commerce." Third Supplemental Appropriation Act, 1951, c. 121, 65 Stat. 52, 59 (46 U.S.C. 1952 ed., Sec. 1241(a)).

Under these facts, the Tax Court's finding (R. 34) that the taxpayer was paid by the United States or an agency thereof seems inescapable.[3] While it may

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[3] It is, of course, obvious that the National Shipping Authority of the Maritime Administration, Department of Commerce, is an agency of the United States within the meaning of the statute. For simplicity, references to the United States herein include this agency.

Since the funds in question were defrayed by the United States through an established agency (the Commerce Department), there was no need for the Tax Court to reach the question whether Pacific—which served as a conduit of the funds under the general agency contract—was also "an agency" of the United States within the purview of the exception clause of Section 911(a). Suffice it to note that even if, as the taxpayer contends, Pacific was the real payor,

be true that the taxpayer's salary checks were issued by Pacific as maker (R. 26), in this capacity, as in all other connections, Pacific was acting as an agent for the United States in distributing funds advanced by the United States from the Civil Operations Revolving Fund. In other words, Pacific was a mere conduit for the payment of wages.

The fact that the wages of the crew were to be paid from United States funds also fits in with general financial arrangements of the agency agreement. All the funds for expenditure of every kind made by the general agent in "performing, procuring, or supplying the services, facilities, stores, supplies, or equipment" as required under the agency agreement were to be advanced by the United States. (Art. 5 of the agency agreement, Ex. 1-A.) Consistent with the concept of Pacific as a conduit for wage payments, all funds advanced for wages and other expenses were used by Pacific solely for these purposes. Pacific was not an independent contractor under the agreement (R. 30) and did not extract its profits for operation of the vessel from the sums advanced by the United States for payment of wages and other expenses. Article 4 of the agreement (Art. 4 of Ex. 1-A) provides that compensation shall be paid the general agent monthly in "fair and reasonable amount" as determined by the United States.

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then it should likewise be treated as such an "agency" (*Sverdrup* v. *Commissioner*, 14 T.C. 859; Treasury Regulations under the 1954 Code, Sec. 1.911(a)(1))—particularly since there is no showing that the payment was subjected to a foreign tax—and the Tax Court's decision should therefore nevertheless be affirmed.

As the Tax Court notes (R. 35), the case of *Teskey* v. *Commissioner*, 30 T.C. 456, involving almost identical facts, is authority for the decision here. A copy of the Tax Court decision in that case is set forth as the Appendix to this brief. See also Rev. Rul. 58-4, 1958-1 Cum. Bull. 687, quoted extensively in the *Teskey* case. The decision by the Tax Court in *Sverdrup* v. *Commissioner*, 14 T.C. 859, also is in point. There it was held that the taxpayer's distributive share of partnership income, which had been earned on construction contracts with the United States, was paid by the United States, the court reasoning that the intervention of the partnership between the flow of such income from the United States to the taxpayer effected no substantial change in the actual result.

The broad scope of the language in Section 911 (a)(2) does not make it necessary that a taxpayer be an employee of the United States or an agency thereof in order to be "paid by" the United States. *Sverdrup* v. *Commissioner*, *supra*. But, in the present case, to add to what we have already argued, it appears that the taxpayer was in fact such an employee. For example, the Third Supplemental Appropriation Act, 1951, *supra*, which established the "Vessel Operations Revolving Fund" from which wage and other expenses are advanced to the general agent, refers to "seamen employed through general agents as employees of the United States, who may be employed in accordance with customary commercial practices in the maritime industry." [Emphasis supplied.] This reference seems applicable to the

taxpayer. He was paid by funds provided by the Act (R. 34), employed through a general agent, and hired, under the agreement, in "accordance with the customary practices of commercial operators" (R. 31).[4] The Act of March 24, 1943, c. 26, 57 Stat. 45, Sec. 1 (50 U.S.C. Appendix, 1952 ed., Sec. 1291) (referred to in *Cosmopolitan Co.* v. *McAllister*, 337 U.S. 783, as the "Classification Act"), whose provisions were made applicable to seamen by the 1951 Act, itself, in setting out limitations on the employment rights of seamen, refers to those "employed on United States * * * vessels as employees of the United States through the War Shipping Administration."

The status of seamen such as the taxpayer has been thoroughly analyzed in *Cosmopolitan Co.* v. *McAllister*, 337 U.S. 783. There, a general agent was engaged under a standard service agreement by the War Shipping Administration[5] to operate a vessel owned by the United States. That agreement was almost identical to the agreement here and *was* identical, even to the numbering of the paragraphs, to Article 3(d) (R. 31-32) of the present agreement which deals with the matter of hiring officers and crew. *Cosmopolitan Co.* v. *McAllister*, *supra*, p. 796.

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[4] The reference to "seamen" in the 1951 Act is to officers and members of the crew. Act of March 24, 1943, c. 26, 57 Stat. 45, Sec. 1 (50 U.S.C. Appendix, 1952 ed., Sec. 1291).

[5] The National Shipping Authority of the Maritime Administration is the successor to the War Shipping Administration. See Note to 50 U.S.C. Appendix, 1952 ed., Sec. 1291, and Note to 46 U.S.C., 1952 ed., Sec. 1111.

The issue in the *Cosmopolitan* case concerned the rights of an injured seaman to sue for compensation, and this question, in turn, partially dependent upon who was the seaman's employer, the general agent or the United States. The Court held that the terms of the agreement—referring specifically to the fact that the crew was paid, as here, from funds advanced by the United States to the general agent—made it clear that the seaman was an employee of the United States.[6]

This decision would seem dispositive of the issue here. The taxpayer, hired under substantially the same terms and conditions as was the seaman in the *Cosmopolitan* case, was also an employee of the United States, and, as such, was necessarily "paid by" the United States or an agency thereof within the meaning of Section 911(a)(2). Even assuming, *arguendo*, that the taxpayer was not an employee of the United States, it is clear from the undisputed facts that he was "paid by" the United States.

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[6] Although, as the taxpayer notes in his brief ,p. 5), the shipping articles in the *Cosmopolitan* case had stamped on them, "You Are Being Employed by the United States", this fact was not the only consideration which influenced the Court's decision. The opinion shows that the Court looked to all facets of the seaman's employment.

CONCLUSION

It is respectfully submitted that the decision of the Tax Court should be affirmed.

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SEPTEMBER, 1959.

APPENDIX

TAX COURT OF THE UNITED STATES

Docket No. 63852

ROBERT W. TESKEY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

(Filed May 29, 1958)

A citizen of the United States, employed as a radio operator on a vessel owned by an agency of the United States and operated by the United States under a contract with a private shipping firm as agent, in shuttle service between Korea and Japan during the Korean War emergency, was paid by a private shipping line as agent of the United States from funds provided specifically for that purpose by the United States. *Held*, such compensation constitutes an amount paid by the United States or any agency thereof within the meaning of section 116 (a) I. R. C. 1939, and section 911 (a) I. R. C. 1954, and is not excludable from gross income even though the employee may be physically present in a foreign country or countries for 510 full days or more of an 18-month period to which such wages are attributable. The Commissioner is sustained in his determination of the deficiencies.

Thomas J. Beddow, Esq., for the petitioner.
Neil J. O'Brien, Esq., for the respondent.

The Commissioner has determined deficiencies in petitioner's income tax for the years 1953 and 1954

in the respective amounts of $2,366.91 and $1,278.04. The explanation in the deficiency notice of the deficiency for 1953 is as follows:

> You have failed to show that for the year 1953 you qualified as a bona fide resident of a foreign country, within the meaning of Section 116 (a) of the Internal Revenue Code, for an uninterrupted period which includes an entire taxable year. You have also failed to show that your foreign employment was part of a period of 18 consecutive months during which you were present in a foreign country or countries for at least 510 full days in such period. "Therefore, your wages of $10,049.76 constitute taxable income."

The deficiency for 1954 is also due to the same kind of adjustment, except in smaller amount, and it is explained in the deficiency notice in a similar manner.

The petitioner assigns error as to the determination of the Commissioner for each of the taxable years and contends his compensation was exempt from taxation.

At the hearing, respondent's counsel stated that the Commissioner no longer contended that petitioner did not reside in a foreign country for the length of time required by the statute but that he does contend that petitioner received his compensation from the United States or one of its agencies and that hence the income of petitioner is not exempt under the statutes relied upon. That is the only issue presented for our decision.

There is no dispute as to the amount of compensation which petitioner received in each of the taxable years.

Findings of Fact.

Most of the facts have been stipulated and the stipulated facts are incorporated herein by this reference.

Petitioner Robert W. Teskey resides at Bethesda, Maryland, and his income tax returns for the years 1953 and 1954 were filed with the district director of internal revenue at Baltimore, Maryland.

Between January 16, 1952, and February 2, 1954, petitioner was a seaman in the Merchant Marine Service of the United States serving as radio operator aboard the motor vessel *Rose Knot*. *Rose Knot* was owned by the United States of America, represented by the Maritime Administration, Department of Commerce. The United States of America (acting by and through the Director, National Shipping Authority of the Maritime Administration) on March 19, 1951, entered into General Agency Agreement MA-56-GAA with Pacific-Atlantic S. S. Co., sometimes hereinafter referred to as Pacific-Atlantic.

Under MA-56-GAA the United States appointed Pacific-Atlantic as its agent, and not as an independent contractor, to manage and conduct the business of the vessels assigned to it for the business and account of the United States and in accordance with the directions, orders, supervision, and inspection as the United States might from time to time prescribe.

The Director, National Shipping Authority of the Maritime Administration, authorized assignment of *Rose Knot* to Pacific-Atlantic. The itinerary of *Rose Knot* was directed by the United States (acting through the Military Sea Transportation Service). *Rose Knot* was used in the shuttle service between ports in Japan and ports in Korea during the Korean War emergency. *Rose Knot* was used to transport

dry commodities such as tanks, vehicles, and ammunition between Japan and Korea.

By the terms of the General Agency Agreement, Pacific-Atlantic was required to procure for *Rose Knot* a master, who was to be an agent and employee of the United States and who was to exercise full control with respect to the manning, navigation, and management of the vessel. Pacific-Atlantic was further required to procure through the usual channels, and make available to the master for engagement, officers and men required by the master to fill the complement of the vessel. The agreement did not carry any provision which said that the officers and crew required to fill the complement of the vessel would be employees of the United States. The officers and crew were subject only to the orders of the master.

On or about January 16, 1952, petitioner was procured out of union hiring hall by Pacific-Atlantic, signed shipping articles of agreement, and was thereupon engaged by the master of *Rose Knot* for service as its radio operator. The terms, pay provisions, and conditions of petitioner's employment were fixed by and according to the union agreement with Pacific-Atlantic.

Petitioner signed subsequent shipping articles of agreement for service aboard *Rose Knot* as its radio operator on October 23, 1952, and July 18, 1953, which articles extended his employment to approximately February 2, 1954.

Rose Knot sailed from Portland, Oregon, on January 22, 1952, and arrived at Yokohama, Japan, on February 18, 1952. *Rose Knot* sailed from Yokohama, Japan, on January 15, 1954, and arrived at Portland, Oregon, on February 1, 1954. Between February 18, 1952, and January 15, 1954, *Rose Knot*

was in shuttle service between ports in Japan and ports in Korea, except for a trip from Yokohama, Japan, to Naha, Okinawa, and return, covering the period December 11, 1953, to December 20, 1953.

While engaged as radio operator aboard *Rose Knot*, petitioner was paid for his services either by check of Pacific-Atlantic or in cash from funds provided therefor by the United States. The service agreement provided that the United States would advance funds to Pacific-Atlantic to provide for the expenses incurred by it in operating the vessel, and that Pacific-Atlantic would be paid fair and reasonable compensation for its services, including in such compensation administration and general expense, advertising expense, taxes, and other indirect expenses.

From payment made to petitioner, Pacific-Atlantic withheld Federal unemployment, social security, and Federal income taxes. Nothing was withheld from such compensation in respect of Federal retirement benefits. Pacific-Atlantic paid unemployment taxes on petitioner's compensation, as well as any pension or welfare fund contributions required by Pacific-Atlantic's collective bargaining agreements. From a revolving fund established by Pub. L. No. 45, 82d Cong., 1st Sess., the United States provided the funds which it placed in a special and joint bank account from which Pacific-Atlantic could make withdrawals for the purposes designated in the General Agency Agreement. The General Agency Agreement required the agent, Pacific-Atlantic, to account for all moneys disbursed. The agreement required the agent to keep books and records (which were to be the property of the United States) and to file financial statements according to the directions of the United States.

The shipping articles stated that the United States or one of its agencies was the owner of *Rose Knot*.

The moneys used to pay the wages earned by the petitioner while engaged as radio operator aboard the *Rose Knot* belonged to and were the funds of the United States or an agency thereof immediately prior to payment to petitioner. The wages earned by petitioner while engaged as radio operator aboard the *Rose Knot* were amounts paid by the United States or an agency thereof.

Opinion.

Black, *Judge*: For the taxable year 1953, petitioner claims that wages received from Pacific-Atlantic in the amount of $10,049.76 are excludable from gross income under section 116 (a) (2), I. R. C. 1939. For the taxable year 1954, petitioner claims that wages received from Pacific-Atlantic in the amount of $6,307.29 are excludable from gross income under section 911 (a) (2), I. R. C. 1954.

Respondent in his answer denied petitioner's claim generally and specifically alleged that petitioner's wages were paid by the United States or an agency thereof.

The sections of the statute above referred to, in substance, provide that income earned abroad by a United States citizen, who is present in a foreign country or countries for at least 17 months out of 18 consecutive months, shall be excluded from gross income. The exclusionary provision does not extend to "amounts paid by the United States or any agency thereof."

The notice of deficiency determined that sections 116 (a) (2) of the 1939 Code and 911 (a) (2) of the 1954 Code were not applicable because petitioner was not present in a foreign country or countries for at least 17 months out of 18 consecutive months.

This position has, however, now been abandoned by respondent.

In his answer to the petition filed, respondent, by way of an affirmative allegation, alleged that the compensation earned abroad by petitioner, during his presence in a foreign country or countries for 17 months out of any period of 18 consecutive months, was paid to him by the National Shipping Authority, Maritime Administration, Department of Commerce, an agency of the United States. Accordingly, the only issue in this case is whether the benefits of sections 116 (a) (2) of the 1939 Code and 911 (a) (2) of the 1954 Code are to be denied to the petitioner on the ground that the compensation reflected in his 1953 and 1954 returns represented "amounts paid by the United States or any agency thereof."

Both parties in their briefs discuss at considerable length the question as to upon whom the burden of proof lies. Petitioner takes the position that the burden of proof lies upon the Commissioner because he shifted his grounds as originally stated in his deficiency notice to another ground as alleged in his answer, to wit, that the compensation received by petitioner was paid to him by "the United States or any agency thereof." The Commissioner argues that the changing of his ground for the disallowance of the exemption from that of insufficient time spent abroad in earning the compensation, to that of the ground that petitioner's compensation was paid to him by "the United States or any agency thereof" has no effect on the burden of proof required in the case. Respondent cites many cases in support of his position. However, we think it is unnecessary to take up any time in discussing in this case upon whom the burden of proof lies.

The facts have been very fully stipulated, except as to one or two minor matters upon which oral testi-

mony was heard. So far as we can see there is no lack of facts to inform us fully as to how and by whom petitioner was employed and by whom he was paid. The facts, as we see them, are really not in dispute. Our task is to give consideration to these facts and determine whether petitioner was paid his compensation by the "United States or any agency thereof." If he was so paid, then he does not get the exemption provided by the statutes upon which he relies. If he was not paid by the "United States or any agency thereof" within the meaning of the applicable statutes, then the amounts of his compensation for both taxable years are exempt from taxation under the statutes relied upon.

We think that under the law and the facts the issue must be decided for the Commissioner. In Rev. Rul. 58-4, I. R. B. 1958-1, 45, the very question here involved was fully considered and ruled upon. The facts upon which that ruling was based are essentially the same as the facts in the instant case. This is shown by quoting from the ruling, pages 46, 47, as follows:

> From January 26, 1954, to July 24, 1955, inclusive, a total of 545 days, the taxpayer lived in Korea and was employed on a shuttle ship which sailed between Korea and Japan. During such period the taxpayer was not within the United States or any possession thereof. The United States, represented by the Maritime Administration, was owner, or owner for the time being, of the ship on which the taxpayer was employed. * * *
>
> The instant agreement appointed a shipping line as general agent under the contract and defined the duties of the general agent. Among these duties was the procurement of a master

who should be an agent and an employee of the United States. The general agent was required to procure and make available to the master, for engagement by him, the officers and men required by him to fill the complement of the vessel. This personnel was procured through usual channels and in accordance with the customary practices of commercial operators and upon the terms and conditions of the general agent's collective bargaining agreements, if any. All such personnel were paid by the general agent in the customary manner with funds provided by the United States for performing, procuring, or supplying services, and for paying all crew expenditures. Operating control of the ship was maintained by the United States through the ship's master.

Upon these facts it was ruled as follows:

> Accordingly, it is held that wages paid by a private shipping line as general agent of the United States, from funds provided for that purpose by the United States, to a citizen of the United States as compensation for services performed on a vessel owned, or owned for the time being, by an agency of the United States and operated by the United States, are not excludable from gross income under the provisions of section 911 (a) (2) of the Code even though the employee may be physically present in a foreign country or countries for 510 full days or more of an 18 consecutive month period to which such wages are attributable. * * *

It will be noted that the foregoing ruling was as to the applicability of section 911 (a) (2) of the 1954 Code. That section is applicable to one of the

years here in question, the year 1954. Section 116 (a) (2) of the 1939 Code is applicable to the year 1953. However, it is essentially the same as section 911 (a) (2) of the 1954 Code and the foregoing internal revenue ruling is equally applicable to the taxable year 1953, as it is to 1954. There is no dispute between the parties on that score.

Petitioner, however, contends that the Commissioner's ruling in Rev. Rul. 58-4, I. R. B. 1958-1, 45, is not correct and should not be followed. Obviously, if this ruling is not correct, it should not be followed. It is well recognized that the Commissioner has no authority to make a ruling which is contrary to an act of Congress and if he does publish such a ruling the courts will not follow it. However, we do not believe that the internal revenue ruling to which we have made reference above is erroneous. It seems to us that it is a correct application of the law to the facts.

Since the United States through the Department of Commerce, Maritime Administration, National Shipping Authority, in satisfaction of its obligation paid wages to the petitioner, albeit payment was made by the United States through its agent, Pacific-Atlantic, the amounts thus received by petitioner were paid by "the United States or any agency thereof," and petitioner is, therefore, not entitled to the exemtpion-exclusion provided by the sections of the statutes to which reference has already been made.

Petitioner strongly maintains that he was never at any time an employee of the United States. Even if that fact be assumed to be correct, we do not think it would change the result. The sections of the statutes which are here applicable except from the exemptions provided, amounts paid by "the United States or any agency thereof." The language is

broad enough to exclude from the exemption provided in the statutes, amounts paid by the "United States or any agency thereof," even though the taxpayer to whom the payment is made is not, strictly speaking, an employee of the United States.

The crucial question is, was the payment made by "the United States or any agency thereof." Cf. *Leif J. Sverdrup*, 14 T. C. 859, 866, (1950). In the *Sverdrup* case, we held that the sum of $36,279.30 received by the taxpayer as a member of a contracting firm was not exempt under section 116 (a) of the 1939 Code, even though the taxpayer was not an employee of the United States Government. The important thing was that the $36,279.30 was paid by the United States Government. Among other things, we said:

> It is significant that the words actually adopted in the amendment were broad. Neither the word "employees" nor the word "compensation" was used. Instead, the amendment as passed reads: "except *amounts paid* by the United States or any agency thereof." (Italics supplied.) Since the sum of $36,279.30 here in question was such an amount, we hold that respondent properly determined that that amount was not excludable from petitioner's gross income in 1942.

We hold that the payments here in question were paid by "the United States or any agency thereof" and are not exempt from taxation. The Commissioner is sustained.

Decision will be entered for the respondent.

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